IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

IN RE:	:	CIVIL ACTION
WILLIAM DAVID KRESSLER	:	NO. 00-5286
and LORI ANN KRESSLER	:	(BANKRUPTCY NO. 99-22646)

MEMORANDUM AND ORDER

HUTTON, J. August 9, 2001

Presently before this Court are the Brief of Appellants (Docket No. 3), the Brief of Appellee Litton Loan Servicing, Inc. Servicer for Cityscape Corp. (Docket No. 8), and the Reply Brief of the Appellants (Docket No. 9).

I. BACKGROUND

Litton Loan Servicing, Inc. (Litton) holds a second mortgage on the residence of the Debtors, William David and Lori Ann Kressler. The Debtors filed a Chapter 13 petition and plan on June 17, 1999 and the deadline for filing a proof of claim was November 1, 1999. Litton filed its proof of claim on November 2, 1999 asserting that it was the holder of a secured claim against the Debtors in the amount of $32,480.16. The Debtors filed an objection to Litton's proof of claim asserting that it was untimely. For that reason, the Bankruptcy Court sustained the Debtor's objection on February 2, 2000.

The Chapter 13 plan filed by the debtors provided for a cramdown to zero of Litton's second mortgage and a cancellation of

Litton's mortgage/lien of record. On November 18, 1999, Litton objected to the confirmation of the Debtor's plan. The Debtor's filed an amended Chapter 13 plan providing that "[h]olders of secured claims shall retain the liens securing such claims and shall be paid as follows: $0 - Cityscape Corp. or Litton Loan Servicing their successors and assigns; second mortgage is totally unsecured, cramdown; Cityscape Corp. to cancel its mortgage/lien of record." Again, Litton objected. After briefing by the parties, the Bankruptcy Court sustained Litton's objection to confirmation of the Debtor's Chapter 13 plan. The Debtors appealed the Bankruptcy Court's decision.

II. DISCUSSION

Where a district court reviews a decision of the Bankruptcy Court on question of fact, it applies a clearly erroneous standard of review. See Pennhurst State Sch. & Hosp. v. Halderman, 465 U.S. 89, 104 S. Ct. 900 (1984). When reviewing the factual findings of the Bankruptcy Court, this Court must adhere to the "clearly erroneous" standard. The Third Circuit stated that district courts must follow this very restrictive standard of review, even if it is inconsistent with a local district court standard. See In re Morrissey, 717 F.2d 100 (3d Cir. 1983). The bankruptcy court's findings of fact must stand unless "the court is left with the definite and firm conviction that a mistake has been committed."

Brager v. Blum, 49 B.R. 626 (E.D. Pa. 1985). However, "the 'clearly erroneous standard' does not apply to questions of law.

Where the question presented is solely one of law, no presumption of correctness applies. The bankruptcy court's legal conclusions may not be approved without our independent determination of the legal questions." In re Gilchrist Co., 410 F. Supp. 1070, 1074 (E.D. Pa. 1976) (citations omitted). See Universal Minerals, Inc. v. C.A. Hughes & Co., 669 F.2d 98, 101-03 (3d Cir. 1981) (district court's review of legal questions is plenary). Therefore, a bankruptcy court's conclusions of law are subject to plenary review. See Will v. Michigan Dept. of State Police, 491 U.S. 58, 109 S. Ct. 2304 (1989). Accordingly, as the Debtors do not challenge any of the Bankruptcy Court's factual findings, the Court is charged with a plenary review of the Bankruptcy Court's conclusions of law.

A. Standing of Litton Servicing, Inc.

The Debtors first objection to the opinion of the Bankruptcy Court is that the court improperly held that Litton had standing to object to the Debtor's proposed plan. "A party in interest may object to confirmation of the plan." 11 U.S.C.A. § 1324 (West 2001). The term "party in interest" is not defined in the Bankruptcy Code (the Code) but it is indirectly suggested that the term includes, among others, the debtor, the trustee, and a creditor. See 11 U.S.C.A. § 1109(b) (West 2001); see also 5

William L. Norton, Jr., Norton Bankruptcy Law and Practice § 122:2 (2d ed. 1997). In defining that term, courts in this district have included anyone "'whose pecuniary interest is directly affected by the bankruptcy proceeding', that is, one who has 'an interest in the res to be administered and distributed.'" In re Aronson, No. CIV.A.94-2497, 1994 WL 497541, at *6 (E.D.Pa. Sept. 12, 1994)(citation omitted). The Debtors assert that Litton is no longer a party in interest, i.e. no longer has a pecuniary interest, because their secured claim was disallowed.

While often overlapping, the issue of whether a party's claim is allowed or disallowed is separate and distinct from the determination of whether they are a party in interest. See In re Henry and Regina Dennis, 230 B.R. 244, 254 (Bankr. N.J. 1999). The Debtors are correct that Litton's secured claim was disallowed, however, that does not end the inquiry. It is well settled that a secured creditor is not obligated to take part in the bankruptcy proceedings and it's failure to do so will not extinguish its lien. See 11 U.S.C.A. § 506 (d)(2) (West 2001); Long v. Bullard, 117 U.S. 617, 620-21, 6 S.Ct. 917, 918 (1886); see also Cen-Pen Corp. v. Hanson, 58 F.3d 89, 92 (4th Cir. 1995); In the Matter of Tarnow, 749 F.2d 464, 466 (7th Cir. 1984). In addition, it is clear that a lien is a property interest for the lienholder. See Tarnow, 749 F.2d at 466. As a result, Litton's lien on the Debtor's residence would stay intact unless it was dealt with in the Debtor's proposed

plan. See Dennis, 230 B.R. at 252. In the instant case, the Debtors plan proposes to cramdown to zero the outstanding loan owed to Litton and cancel Litton's mortgage/lien of record. Because the proposed plan results in the extinguishing of a property interest of Litton, the Court finds that Litton has a pecuniary interest in the plan and is therefore a party in interest with standing to object to confirmation.

The Debtors rely, in large part, on the decision of the court in In re Dennis. In Dennis, the creditor objected to the plan because it undervalued their secured claim. However, because the court had already disallowed their proof of claim as being untimely, the creditor had no means of proving that it was owed more than was provided for in the plan. To allow the creditor to object to the confirmation of the plan would be a moot point because they would not be able to sustain their burden of proof as to the objection. Therefore, the court held that "a creditor whose claim has been disallowed is not a party in interest if the basis for the objection to confirmation is the failure to pay a proof of claim which has been disallowed." Dennis, 230 B.R. at 255. In the instant case, Litton is objecting to confirmation of the plan on the basis that the method of cramdown is procedurally defective, they do not object on the basis of a failure of the plan to pay their disallowed claim. Therefore, the finding that Litton is a party in interest is consistent with the court's holding in Dennis.

For the foregoing reasons, the Court finds that the Bankruptcy Court did not err in finding that Litton was a party in interest with standing to object to the confirmation of the Debtor's plan.

B. The Substance of Litton's Objection

The Debtors next object to the Bankruptcy Court's ruling that a Debtor may not cramdown and avoid a secured creditor's lien through the plan confirmation process without first taking an "affirmative step" such as filing an adversary complaint to avoid the lien. The Bankruptcy Court held that the relevant rules addressing this issue were Bankruptcy Rules 7001(2), 3007, and 3012. See Fed. R. Bankr. P. 7001(2), 3007, 3012 (West Supp. 2001). The court saw these as the Rules governing the procedural intricacies of instituting an action to determine the extent, validity and/or priority of a lien. The Debtors disagree and appeal the court's determination.

As discussed above, Litton's failure to file a timely proof of claim did not extinguish its lien on the Debtor's residence. See § 506 (d)(2). As the Debtor's plan proposes to pay Litton nothing and have their mortgage/lien of record cancelled, there is little doubt that the Debtors are seeking to void Litton's lien. Section 502(d) provides that "[t]o the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void, **unless** . . . (2) such claim is not an allowed secured claim due only to the failure of any entity to file a proof of such

claim under section 501 of this title." § 502(d) (emphasis added). This provision makes clear that Litton's claim is not void by virtue of being disallowed. The next logical conclusion is that some additional step must be taken to render it void.

While the Debtors claim that the additional step necessary could be confirmation of the plan itself, the Court disagrees. Rule 7001(2) makes clear that a determination of the "validity, priority, or extent of a lien or other interest in property" takes place in an adversary proceeding. See Fed. R. Bankr. P. 7001(2); see also Cen-Pen Corp., 58 F.3d at 93. This rule makes sense because to allow a debtor to invalidate a lien without some form of adversary proceeding would render meaningless the settled rule that a lien passes through the bankruptcy unaffected. See Cen-Pen Corp., 58 F.3d at 92. That is why the Court in Cen-Pen Corp. stated that "[f]or a debtor to extinguish or modify a lien during the bankruptcy process, some affirmative step must be taken toward that end." Id. This Court agrees and finds that "a lien may not be invalidated over the objection of the lienholder as part of a plan of reorganization." 10 Collier on Bankruptcy § 7001.03[1] (15th ed. 2001).

For the foregoing reasons, the Court finds that the Bankruptcy Court did not commit error when it sustained the objection to confirmation by Litton.

III. CONCLUSION

The Court finds that the Bankruptcy Court properly found Litton Loan Servicing, Inc. (Litton) to be a party in interest with standing to object to confirmation of the Debtors' proposed plan pursuant to 11 U.S.C.A. § 1324. In addition, the Bankruptcy Court was correct in finding that the Debtors cannot rely on the confirmation process to avoid the secured creditor Litton's lien on their residence but instead must initiate an adversary proceeding. As a result, the Court affirms the September 12, 2000 Order of the Bankruptcy Court and remands the case for further proceedings.

An appropriate Order follows.

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

IN RE:	:	CIVIL ACTION
WILLIAM DAVID KRESSLER	:	NO. 00-5286
and LORI ANN KRESSLER	:	(BANKRUPTCY NO. 99-22646)

O R D E R

AND NOW, this 9th day of August, 2001, upon consideration of the Brief of Appellants (Docket No. 3), the Brief of Appellee Litton Loan Servicing, Inc. Servicer for Cityscape Corp. (Docket No. 8), and the Reply Brief of the Appellants (Docket No. 9), IT IS HEREBY ORDERED that the Order and Opinion of the Bankruptcy Court dated September 12, 2000 is **AFFIRMED**; and

IT IS HEREBY FURTHER ORDERED that this matter is **REMANDED** to the Bankruptcy Court for further proceedings.

BY THE COURT:

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HERBERT J. HUTTON, J.